



The New 504 First Mortgage Loan Pool Program

Background:

As part of the American Recovery and Reinvestment Act (ARRA), the U.S. Small Business Administration (SBA) temporarily established a secondary market for 504 first mortgages called the **First Mortgage Loan Pool Program (FMLP)**. The first guarantees are expected to be issued in August 2010.

SBA eligibility is determined based on the SBA debenture funding dates. First mortgages with a funding date on or after February 2009 and prior to September 2012 are eligible for the program. *A first mortgage funded in 2008 (or earlier) could still be eligible to be sold.*

There are three participants for any individual loan:

1. The **Seller** (504 first mortgage lender) who holds 15% of each loan.
2. The **Pool Originator** who purchases 85% of each loan from the seller, and holds 5% of each loan pool for the life of that pool.
3. The **Investor** who purchases 80% of each loan from the pool originator.

SBA provides a guarantee on 504 pools for the benefit of the investor. The guarantee does not apply to the underlying lender, the Pool Originator, or individual loans.

Colorado Lending Source (CLS) and a consortium of Certified Development Companies have partnered with a major U.S. investment bank to purchase 85% participation interests in individual 504 first mortgages through the following process:

- CLS will provide a price indication for an individual loan or group of loans the seller wants to sell based on a CLS-provided loan tape or individual loan price indication worksheet.
- If the price indication meets seller approval, we will then ask the seller to provide a credit memorandum, commitment letter, or worksheet indicating the borrowers structure, guarantors, affiliates, etc.
- Based on the borrowing structure, the seller will then be emailed a link by which to upload the loan package.
- We will then underwrite the loan for approval.
- And if approved, we will issue a Commitment Letter to the seller.

Benefits:

Capital Relief	By selling 85% of each average first mortgage, the first-mortgage lender is funding only 7.5% of each real estate transaction (=15% of an average 50% first mortgage).												
Regulator Relief	Many banks are being told by regulators to reduce their concentration of CRE loans. Lower the percent of first mortgages on the books to 15% will help satisfy regulators.												
Credit Quality	<p>The seller's loan interest is 15% of each 504 first mortgage. Any losses are shared pro rata with the Pool Originator, and the investor. A typical transaction highlights the protection provided to the seller:</p> <p>Purchase Price: \$1,000,000 First Mortgage: \$500,000 SBA Debenture: \$400,000</p> <table border="1" data-bbox="386 779 1481 909"> <thead> <tr> <th>Liquidation Scenario</th> <th>First Mortgage Shortfall</th> <th>Seller's Share of Loss</th> </tr> </thead> <tbody> <tr> <td>40% Decline In Value</td> <td>\$0</td> <td>\$0</td> </tr> <tr> <td>60% Decline In Value</td> <td>\$100,000</td> <td>\$15,000</td> </tr> </tbody> </table>	Liquidation Scenario	First Mortgage Shortfall	Seller's Share of Loss	40% Decline In Value	\$0	\$0	60% Decline In Value	\$100,000	\$15,000			
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Premium Income	<p>The first mortgage lender will realize premium income on the Gross Loan Interest (85%) of the first mortgage. An example of the transaction is shown below:</p> <table border="1" data-bbox="386 1066 1481 1222"> <thead> <tr> <th>Loan Amount</th> <th>Gross Loan Interest (85%)</th> <th>Sample Par Rate</th> <th>Sample Markup</th> <th>Effective Rate</th> <th>Premium Percentage & Income</th> </tr> </thead> <tbody> <tr> <td>\$1,000,000</td> <td>\$850,000</td> <td>5.75%</td> <td>1.00%</td> <td>6.75%</td> <td>4%-\$34,000</td> </tr> </tbody> </table>	Loan Amount	Gross Loan Interest (85%)	Sample Par Rate	Sample Markup	Effective Rate	Premium Percentage & Income	\$1,000,000	\$850,000	5.75%	1.00%	6.75%	4%-\$34,000
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Servicing Income & Gross Yield	<p>In addition to premium income, the seller will earn at least .50% servicing income on the Gross Loan interest sold as required by SBA. It's possible that if pricing exceeds the premium max noted above, servicing income will increase dollar for dollar. Using the example in the Premium section above, if the selling first mortgage lender were able to charge a rate of 7.00% the servicing spread would increase to .75%. The table below compares the benefits and effects of the 6.75% rate with .50% in servicing.</p> <table border="1" data-bbox="386 1562 1481 1692"> <thead> <tr> <th>Servicing Percentage</th> <th>Servicing Dollars</th> <th>Additional Yield</th> <th>All In Yield</th> </tr> </thead> <tbody> <tr> <td>.50%</td> <td>\$4,250</td> <td>2.83%</td> <td>9.58%</td> </tr> <tr> <td>.75%</td> <td>\$6,375</td> <td>4.25%</td> <td>11.25%</td> </tr> </tbody> </table>	Servicing Percentage	Servicing Dollars	Additional Yield	All In Yield	.50%	\$4,250	2.83%	9.58%	.75%	\$6,375	4.25%	11.25%
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Relationship Building	Historically, the secondary market for 504 first mortgages required the seller to sell the entire loan to a secondary lender. This impeded the bank's ability to build stronger relationships with the borrower. This new SBA program will allow the selling bank to retain a loan interest and all servicing rights. The sale of the majority of the loan is transparent to the borrower.												

<p>More Loan Sales Opportunities</p>	<p>Unlike existing secondary lender buyers, CLS's Pool Originator will accept virtually all property types including multi-purpose, hospitality, restaurant, properties with excess land, and other special purpose properties. In addition, the approval guidelines will be much more flexible and can include applicants with projected income, less management experience, or some derogatory credit history.</p> <p>Unlike the existing secondary market where one price fits all, the new secondary market will provide a price for a wide range of property types and qualifications. This equals many more selling opportunities for 504 first mortgage lenders.</p>
<p>Flexible Terms</p>	<p>Any rate structure is acceptable, but a rate sheet will regularly be published for 90 day Adjustable, 5 year fixed, 7 year fixed, 10 year fixed and 25 year fixed.</p>

Key Information:

In anticipation of utilizing the new program, first mortgage sellers should note the following:

- Since the Pool Originator is required to hold 5% of each loan pool, a complete loan package will be required and underwritten. *A complete loan package is basically the package the bank holds after funding the first mortgage.*
- SBA requires the first-mortgage payment to be automatically deducted on the 1st of every month. If an existing loan does not have either auto withdrawal and/or a payment date of the 1st, the loan will have to be modified prior to acceptance into an SBA pool.
- Loan amounts are expected to range from \$250,000 to \$5,000,000, although there is no hard cap on the dollar amount of a 504 first mortgage. *Please call us for custom quotes on larger loans.*
- For new loans, sellers are encouraged to price off of 90 Day LIBOR or LIBOR Swap as loans based on these indicies will yield the highest premium.
- We can assist those banks wishing to be a Self Pool Originator.

Resources:

First Lien Position 504 Loan Pooling Program Guide:

http://nadco.org/files/public/timemosfy10/ti06_10_attachment_2.pdf

SBA Form 2401 First Lien 504 Loan Pool Guarantee Agreement:

http://www.sba.gov/idc/groups/public/documents/sba_homepage/tools_sbf_forms_2401.pdf

*If you have further questions about this process please contact us at:
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Colorado Lending Source is a private, nonprofit, economic development organization with a mission to foster the economic growth of diverse small businesses within our communities.